Multi-asset in today's low-return environment

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Global CIO Jeff Hussey discusses how unrealistic expectations for investment returns are today, in the current low-return environment. We believe investors should consider a multi-asset approach that is active, targeted and dynamic.

Today's low-return environment

Along with most other forecasters, our team at Russell Investments forecasts a low-return investing environment for the foreseeable future.[1] Demographics and low mortality rates in particular are having a large impact on defined benefit pension deficits. However, many investors base their retirement savings plans on overestimated and unrealistic levels of return. For example, corporate pension funds predict an investment return of 6.4%[2] in the UK and 7%[3] in the US.

So how realistic are these expectations? Our forecasting team projects that a 60/40 passive portfolio built from 60% MSCI World Index and 40% Bloomberg Barclays U.S. Aggregate Bond Index will likely yield only 4.8% annual return over the next ten years.

We're not alone in this thinking. A survey of professional forecasters conducted by the Federal Reserve Bank of Philadelphia showed that the expected return for a typical 60/40 portfolio over the next ten years is 3.5 percentage points lower than it was in the early 1990s. [4]

The low-return imperative The low-return imperative well-defines what we believe is the single greatest challenge investors face today. When expected future market returns are likely to be lower than the required rate of return, we believe an investor cannot afford to ignore any investment strategy that may offer incremental return, take on risks they do not expect to get paid for or disregard implementation efficiency.

That is, if returns from capital markets are likely to be lower going forward than they have been in the past, it is absolutely **'imperative'** that investors seek additional sources of return to improve the probability of achieving their objectives.

Passive investing and the low-return imperative

Today, many investors are focusing on reducing fees as a way to potentially increase the actual performance received. But prioritising fees can cause investors to rotate out of actively managed investments into passive ones - thereby decreasing the likelihood of achieving anything more than the index-based return.

Passive investing alone will never outperform the market If the markets are performing very well, then passive may be the best way to go. But what happens when markets are in a low-return environment like they are today — when they may be delivering a rate of return below what investors need?

A passive portfolio may make a 5% expected market return for example, more certain than an active portfolio — but 5% is not in line with the estimations of the UK (6.4%) and the US (7%), we saw earlier.

So then, if investors go passive to save on fees, but fail to reach their desired investment outcomes because of such a low-return, who wins?

Take a multi-asset approach

In this low-return environment, investors need to work harder for outperformance. We believe that the likelihood of success could increase via a multi-asset approach which considers:

- Net of fee alpha from active management
- Targeted exposures
- Dynamic asset allocation

Net-of-fee alpha from active management Passive, by its nature, will underperform the market — because it tracks the market, but then includes fees. It cannot beat the market. And any exposure to the market includes exposure to risk. Active management, while it also inherently includes risk and fees, provides the potential for outperformance.

Targeted exposures Delivering on investor outcomes in a low-return environment requires access to more exposures, not less. But we believe gaining access to precise exposures at the right time requires skill. Niche market segments — such as infrastructure, emerging markets, and commodities, among others — lend themselves to providing potential opportunity when gauged through the lens of highly specialised active managers.

Dynamic asset allocation Constantly managing exposures and allocations requires a deep understanding of global markets and cycles, but it also requires 24/7 focused commitment. Be sure that your investment solutions provider has the trading and implementation capabilities to potentially take advantage of tactical upside opportunities and minimise unrewarded risk.

Today's low-return environment is real. The choices investors face are unavoidably hard. By taking a diversified and multi-asset approach, we believe investors will have the highest likelihood of achieving the outcomes they're working so hard to reach.

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[1] OECD. Global Economic Outlook. June 2017.

[2] Van der Wal, D. The Measurement of International Pensional Obligations. 2014.

[3] Goldman Sachs. Seven is the new eight. October 2015

[4] Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters and Russell Investments. Data as of January 2017.

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